

FINANCIAL RELATED AUDIT
OF THE
DEPARTMENT OF MILITARY AND VETERANS AFFAIRS

October 1, 1995 through September 30, 1997

EXECUTIVE DIGEST

DEPARTMENT OF MILITARY AND VETERANS AFFAIRS

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| INTRODUCTION | This report contains the results of our financial related audit* of the Department of Military and Veterans Affairs for the period October 1, 1995 through September 30, 1997. |
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| AUDIT PURPOSE | This financial related audit was conducted as part of the constitutional responsibility of the Office of the Auditor General. Financial related audits are conducted at various intervals to permit the Auditor General to express an opinion of the State's financial statements. Also, this audit complements the departmentwide financial audit. |
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| BACKGROUND | The Department is responsible for training the Michigan National Guard to ensure military preparedness and for operating and maintaining military training sites and support facilities. |
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The Department is also responsible for addressing the needs of Michigan veterans through its operation of two State veterans' homes, which provide domiciliary and nursing care to aged and disabled military veterans. The

* See glossary on page 17 for definition.

Department also administers the Michigan Veterans' Trust Fund, provides grant funding to veteran service organizations, and provides administrative support for the Vietnam Veterans' Memorial Monument Fund.

For fiscal years 1996-97 and 1995-96, the Department's total General Fund expenditures and operating transfers out were \$77.2 million and \$74.5 million respectively.

**AUDIT OBJECTIVES
AND CONCLUSIONS**

Audit Objective: To assess the effectiveness* of the Department's internal control structure* over its financial operations.

Conclusion: We concluded that the Department's internal control structure over its financial operations was reasonably effective. However, our review disclosed reportable conditions* related to incompatible user classes*, payroll and personnel transactions, inventory controls, and member accounts (Findings 1 through 4).

Audit Objective: To assess the efficiency* of the Department's internal control structure over its financial operations.

Conclusion: We concluded that the Department's internal control structure over its financial operations was reasonably efficient. However, our review disclosed a reportable condition related to procurement cards (Finding 5).

AUDIT SCOPE

Our audit scope was to examine the financial and other records of the General Fund operations of the Department of Military and Veterans Affairs for the period October 1, 1995 through September 30, 1997. Our audit

* See glossary on page 17 for definition.

was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

**AGENCY RESPONSES
AND PRIOR AUDIT
FOLLOW-UP**

Our audit report contains 5 findings and 7 corresponding recommendations. The agency's preliminary response indicated that the Department has complied or will comply with all of the recommendations.

The Department had complied with 11 of the 12 prior Single Audit* recommendations included within the scope of our current audit.

* See glossary on page 17 for definition.

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Major General E. Gordon Stump, Director
Department of Military and Veterans Affairs
2500 South Washington
Lansing, Michigan

Dear General Stump:

This is our report on the financial related audit of the Department of Military and Veterans Affairs for the period October 1, 1995 through September 30, 1997.

This report contains our executive digest; description of agency; audit objectives, audit scope, and agency responses and prior audit follow-up; comments, findings, recommendations, and agency preliminary responses; and a glossary of acronyms and terms.

Our comments, findings and recommendations are organized by audit objective. The agency preliminary responses were taken from the agency's responses subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

Sincerely,

Thomas H. McTavish, C.P.A.
Auditor General

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Description of Agency

The Department of Military and Veterans Affairs is responsible for training the Michigan National Guard to ensure military preparedness and for operating and maintaining military training sites and support facilities. In addition, the Department oversees grants to 12 veterans' service organizations.

The Department is also responsible for addressing the needs of Michigan veterans through its operation of two State veterans' homes. The Grand Rapids Home for Veterans (GRHV) was established in 1885 and provides domiciliary and nursing care to aged and disabled military veterans in the State. The D.J. Jacobetti Home for Veterans (JHV), located in Marquette, began operations in 1981 to provide domiciliary and nursing care to aged and disabled military veterans in Michigan's Upper Peninsula.

In addition, the Department is responsible for the supervision and direction of the Michigan Veterans' Trust Fund, which was transferred to the Department in September 1995 by Executive Order 1995-15. The Fund provides grants to assist veterans and their dependents. The Fund also provides administrative support for the Vietnam Veterans' Memorial Monument Fund.

For fiscal years 1996-97 and 1995-96, the Department's total General Fund expenditures and operating transfers out were \$77.2 million and \$74.5 million, respectively.

Audit Objectives, Audit Scope, and Agency Responses and Prior Audit Follow-Up

Audit Objectives

Our financial related audit of the Department of Military and Veterans Affairs had the following objectives:

1. To assess the effectiveness of the Department's internal control structure over its financial operations.
2. To assess the efficiency of the Department's internal control structure over its financial operations.

Our audit, relative to the objective for assessing the effectiveness of the Department's internal control structure, complements the departmentwide financial audit of the Department of Military and Veterans Affairs.

Audit Scope

Our audit scope was to examine the financial and other records of the General Fund operations of the Department of Military and Veterans Affairs for the period October 1, 1995 through September 30, 1997. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Agency Responses and Prior Audit Follow-Up

Our audit report contains 5 findings and 7 corresponding recommendations. The agency's preliminary response indicated that the Department has complied or will comply with all of the recommendations.

The agency preliminary response which follows each recommendation in our report was taken from the agency's written comments and oral discussion subsequent to our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and Department of Management and Budget Administrative Guide procedure 1280.02 require the

Department of Military and Veterans Affairs to develop a formal response to our audit findings and recommendations within 60 days after release of the audit report.

The Department complied with 11 of the 12 prior Single Audit recommendations included within the scope of our current audit.

COMMENTS, FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

EFFECTIVENESS OF THE INTERNAL CONTROL STRUCTURE

COMMENT

Audit Objective: To assess the effectiveness of the Department of Military and Veterans Affairs' internal control structure over its financial operations.

Conclusion: We concluded that the Department's internal control structure over its financial operations was reasonably effective. However, our review disclosed reportable conditions related to incompatible user classes, payroll and personnel transactions, inventory controls, and member accounts.

FINDING

1. Incompatible User Classes

The Department did not provide sufficient separation of duties when processing accounting transactions. Also, the Department did not prevent personnel from sharing their user passwords.

Our review disclosed that Office of Financial Services (OFS) personnel had incompatible user class assignments. In addition, finance personnel at the Grand Rapids Home for Veterans (GRHV) shared passwords to process transactions in a timely manner, which resulted in incompatible user class combinations at GRHV.

The ability to perform various functions in the Relational Standard Accounting and Reporting System (R*STARS) is controlled by user class assignments. Incompatible user classes result when a combination of assigned user classes gives a single user the ability to process transactions without sufficient oversight. Consequently, several staff members could post and release transactions, including journal vouchers, interaccount billings, cash receipts, and fund overrides. Our review of sampled items did not disclose any inappropriate

transactions. However, the lack of separation of duties increases the risk that an improper or erroneous transaction will not be detected or corrected in a timely manner.

Michigan Administrative Information Network (MAIN) Financial Administration and Control System (FACS) Security Manual, section 3.1, states that the agency is responsible for maintaining appropriate segregation of duties to achieve effective internal controls. This includes ensuring that users do not have incompatible capabilities. The Department took steps to eliminate several incompatible user class combinations that we identified during our audit.

RECOMMENDATIONS

We recommend that the Department provide sufficient separation of duties when processing accounting transactions.

We also recommend that the Department prevent the sharing of passwords.

AGENCY PRELIMINARY RESPONSE

The Department agreed with the audit finding and recommendations. The Department informed us that it has taken steps to eliminate some of the incompatible user classes and will continue to review security classes and take steps whenever possible to eliminate incompatible user classes. However, because of staffing limitations, the Department believes that it is not always possible to avoid incompatible user class combinations. The Department also informed us that Department staff have been reminded to maintain security over individual passwords.

FINDING

2. Payroll and Personnel Transactions

GRHV did not have a proper separation of duties for performing payroll and personnel document preparation and data entry.

MAIN Human Resources System (HRS) procedures manual section 14.6 requires that time and attendance be entered by an employee who does not also prepare or

approve timekeeping reports. Our review of GRHV's payroll-personnel procedures disclosed that an employee entered her own time on Personnel-Payroll Information System for Michigan (PPRISM) after the report was signed by the certifier.

GRHV informed us that this situation resulted because of staffing shortages. Accordingly, GRHV should establish compensating controls, such as an independent reconciliation of the payroll and personnel entries to reduce the risk of erroneous or improper transactions.

RECOMMENDATION

WE AGAIN RECOMMEND THAT GRHV SEPARATE THE DUTIES OF PERFORMING PAYROLL AND PERSONNEL DOCUMENT PREPARATION AND DATA ENTRY OR PROVIDE COMPENSATING CONTROLS.

AGENCY PRELIMINARY RESPONSE

The Department agreed with the finding and recommendation. The Department informed us GRHV is now in compliance with the recommendation as GRHV staff have been reassigned to ensure a proper separation of duties.

FINDING

3. GRHV Inventory Controls

GRHV did not perform physical counts of its supplies and materials inventory items for fiscal year ended September 30, 1997. Also, GRHV did not require an authorizing signature on requisitions for the issuance of inventoried items or limit access to the inventory storeroom.

Department of Management and Budget (DMB) Administrative Guide procedure 1270.04 requires agencies to perform an annual count of inventory items, maintain a list of individuals authorized to approve requisitions of inventory items, and limit access to inventory storage areas. These basic controls reduce the risk of inventory loss and ensure the accuracy of reported inventory information.

RECOMMENDATION

We recommend that GRHV perform annual physical counts of its supplies and materials inventory, require authorized signatures on inventory requisitions, and limit access to the inventory storage area.

AGENCY PRELIMINARY RESPONSE

The Department agreed with the audit finding and recommendation. The Department informed us that GRHV will annually complete a physical inventory count. Also, the Department informed us that GRHV has established a list of authorized signatures for the requisitioning of inventory items and that GRHV will take steps to secure and limit access to the inventory storage area.

FINDING

4. Member Accounts

The Department did not account for the daily activity related to veterans' home members' personal assets on the State's accounting system, thus diminishing the internal control and benefit of central oversight of funds held in a trust capacity. In addition, the veterans' homes maintained separate checking and savings accounts.

Section 21.181 of the *Michigan Compiled Laws* requires the State Treasurer to keep all bank accounts, where State money may be deposited, on the State's accounting records. In addition, the Department of Treasury's policy prohibits State agencies from using outside financial institutions and investment firms to establish or maintain accounts, to obtain check writing capabilities, or to make investments, including patient money. Also, Section 36.12 of the *Michigan Compiled Laws* states that the method for accounting for funds deposited with the State Treasurer, by the veterans' homes, shall be similar to other State institutions.

Other State institutions holding funds in a trust capacity are required to maintain all activity on the State's accounting records.

Currently, the veterans' homes maintain separate checking and saving accounts totaling approximately \$654,000 for their members. The Department of Treasury had instructed the Department to transfer the member funds to the Department of

Treasury and to close the financial institution accounts by March of 1996. The Department did record the balance of these accounts on the State's accounting records at the end of fiscal year 1995-96. However, the Department did not record the daily activity related to members' funds on the State's accounting records nor did it close the financial institution accounts.

RECOMMENDATIONS

We recommend that the Department account for the daily activity related to veterans' home members' personal assets on the State's accounting system.

We also recommend that the Department close the separate checking and savings accounts.

AGENCY PRELIMINARY RESPONSE

The Department agreed with the audit finding and recommendations. The Department will form a work group to evaluate the funds transfer process and to identify the actions required to facilitate a transfer in a timely manner.

The Department would like to stress that the transfer of member funds to another financial institution is a very sensitive issue with the veterans' groups. Any action to transfer funds, even when the transfer will not impact the members' access to their own funds, must be handled with care.

EFFICIENCY OF THE INTERNAL CONTROL STRUCTURE

COMMENT

Audit Objective: To assess the efficiency of the Department's internal control structure over its financial operations.

Conclusion: We concluded that the Department's internal control structure over its financial operations was reasonably efficient. However, our review disclosed a reportable condition related to procurement cards.

FINDING

5. Procurement Cards

The Department's procedures did not provide for the efficient reconciliation and recording of procurement card purchases. Procurement cards are credit cards that can be used for purchases of less than \$1,000. Our review disclosed:

- a. The Department's procedure for procurement cards requires the Office of Financial Services (OFS) to reconcile and make payments for all procurement card purchases, including those made by the veterans' homes. Generally, the homes make payments for their own expenditures. The homes are required to submit their procurement card receipts to OFS.

In our review, we noted that OFS did not have sufficient staff resources to reconcile the receipts with the billings prior to payment because of the format in which the receipts were submitted by the homes. Receipts were not attached to applicable billing statements and some were for prior billings. Requiring the homes to reconcile and make their own direct payments would minimize the effort used in reconciling and paying for procurement card purchases.

- b. The Department initially recorded all procurement card purchases to one general object code. The Department later processed journal vouchers to move the expenditures to the proper object code. This process increased the number of adjustments required in the accounting system to properly reflect expenditures. The process also increased the risk of an erroneously recording a procurement card transaction.

RECOMMENDATION

We recommend that the Department improve procedures to help ensure that all procurement card purchases are reconciled and properly recorded.

AGENCY PRELIMINARY RESPONSE

The Department agreed with the audit finding and recommendation. The Department informed us that it has adopted new practices and is writing procedures for reconciling credit card purchases.

Glossary of Acronyms and Terms

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| DMB | Department of Management and Budget. |
| effectiveness | Program success in achieving mission and goals. |
| efficiency | Achieving the most outputs and outcomes practical for the amount of resources applied or minimizing the amount of resources required to attain a certain level of outputs or outcomes. |
| FACS | Financial Administration and Control System. |
| financial related audit | An audit that includes determining whether (1) financial information is presented in accordance with established or stated criteria, (2) the entity has adhered to specific financial compliance requirements, or (3) the entity's internal control structure over financial reporting and/or safeguarding assets is suitably designed and implemented to achieve the control objectives. |
| GRHV | Grand Rapids Home for Veterans. |
| HRS | Human Resources System. |
| internal control structure | The management control environment, accounting system, and control policies and procedures established by management to provide reasonable assurance that resources are safeguarded; that resources are used in compliance with laws and regulations; and that financial transactions are properly accounted for and reported. |
| JHV | D.J. Jacobetti Home for Veterans. |

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| Michigan Administrative Information Network (MAIN) | A fully integrated automated financial management system for the State of Michigan. |
| OFS | Office of Financial Services. |
| PPRISM | Personnel-Payroll Information System for Michigan. |
| reportable condition | A matter coming to the auditor's attention that, in his/her judgment, should be communicated because it represents either an opportunity for improvement or a significant deficiency in the design or operation of the internal control structure or in management's ability to operate a program in an effective and efficient manner. |
| R*STARS | Relational Standard Accounting and Reporting System. |
| Single Audit | A financial audit performed in accordance with the Single Audit Act of 1984 that is designed to meet the needs of all federal grantor agencies and other financial report users. A Single Audit is a financial audit which requires additional study and evaluation of the internal control structure and testing of compliance with laws and regulations relevant to federal assistance programs. |
| user class | Defines a user's ability to access the system. |